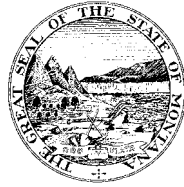


LEGISLATIVE AUDIT DIVISION

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TO: Legislative Audit Committee Members
FROM: Jim Pellegrini, Deputy Legislative Auditor, Performance Audits
CC: Richard Oppen, Director, Department of Environmental Quality
Tom Livers, Deputy Director, Department of Environmental Quality
Greg Cross, Chairman, Petroleum Tank Release Compensation Fund Board
Terry Wadsworth, Executive Director, Petroleum Tank Release Compensation Fund Board
DATE: January 26, 2006
RE: Follow-up to Performance Audit 06SP-022: Petroleum Tank Release Compensation Fund, Department of Environmental Quality (orig. report 02P-09)

INTRODUCTION

In November 2003, we presented our performance audit of the Petroleum Tank Release Compensation Fund (Petrofund) to the Legislative Audit Committee. The audit report made nine recommendations to either the Petroleum Tank Release Compensation Fund Board or the Department of Environmental Quality. One recommendation was also directed to the legislature. During 2005, we requested and received information from the board and the department on their progress in implementing recommendations. In addition to summarizing the results of our follow-up work, this memo will present background information on program activities.

Overview

Our performance audit of the Petroleum Tank Release Compensation Fund (Petrofund) included findings and recommendations addressing improvements in fund solvency and management of fund activities by the board and Department of Environmental Quality. Seven recommendations or parts of recommendations were addressed to the Petrofund board, which has fully implemented or is currently implementing all these recommendations. Five recommendations or parts of recommendations were addressed to the department. The department has implemented or is currently implementing all these recommendations. One audit recommendation related to transitioning Petrofund coverage to private sector insurers was addressed to the legislature. This recommendation is being partially implemented through passage of Senate Bill 145 during the 2005 regular session.

BACKGROUND

The Legislative Audit Committee requested a performance audit of the Petroleum Tank Release Compensation Fund (Petrofund) for the 2001 biennium. Petrofund was established by the Montana legislature in 1989 to pay for allowable costs associated with releases from petroleum storage tanks and is funded through a tax levied on distribution of petroleum products. Petrofund was established in response to environmental and health problems posed by accidental releases of petroleum products. When petroleum products enter the environment they pose a threat to human and environmental health. In response to this federal regulation, many states established fund programs to pay for cleanup costs associated with leaking tanks.

Fund Administration

Fund administration is a joint responsibility of the Petroleum Tank Release Compensation Fund Board (the Board) and the Department of Environmental Quality (the department.) The fund is administered by the Board and its staff with support from the department. Petrofund provides compensation of up to \$1 million per release. Tank owner/operators share in the cost of cleanup through a deductible.

Department Functions

The department's compliance program ensures tanks are registered annually with the department and inspected regularly. The goal of the compliance program is release prevention. The department also regulates release cleanup. Department staff monitors cleanup progress through a corrective action plan defining the extent of contamination and proposed cleanup actions. Cleanup can involve substantial costs for the owner/operator of the tank. Petrofund is used to reimburse owner/operators for the costs associated with cleanup.

Fund Solvency

Over the life of the fund, expenditures exceeded revenues in six of ten fiscal years. Since FY 1997, Petrofund posted a negative FY-end fund balance on one occasion. For four out of seven years, the FY -end balance was below \$1 million. Fund solvency is dependent on the relationship between fund revenues and expenditures. Solvency is maintained when revenue collected exceeds disbursement of expenditures. The solvency of the fund is threatened when the reverse is true.

Failure to arrest the trend towards insolvency could result in delays in compensation payments to tank owner/operators and could also adversely affect facility compliance status under federal and state law. There could also be negative environmental and human health consequences if resources are not available for cleanup. To safeguard solvency in the future, we recommended changes in Petrofund management and operations. Recommendations addressed changes in the management approach of the Board and the functional role and responsibilities assigned to the department. Recommendations also addressed improvements in fund solvency through more proactive management and increased efficiency and effectiveness in Petrofund operations.

Follow-up Audit Findings

The performance audit report included nine recommendations addressed to the Board, the department or jointly to the Board and the department. One recommendation was addressed to legislature. The following summarizes information relating to follow-up audit work and the implementation status of recommendations.

Recommendation #1

We recommend the Board adopt a proactive approach to management of fund liabilities by seeking statutory authority to revise its role to include analysis of fund activity and review of the fund's exposure to liabilities.

Implementation Status – Implemented

Passage of Senate Bill 145 during the 2005 legislative session implemented this recommendation through revisions in statute addressing the role of the Board. Section 75-11-318, MCA, was amended to require the Board to conduct analysis of the long and short-term viability of the fund. The Board is now required in statute to regularly analyze and report on fund expenditures and revenues, exposure to long-term liabilities and other issues impacting the fund's viability and solvency. The results of the Board's analysis will be reported to the department and to the Legislative Auditor prior to each regular session of the legislature. Mandating ongoing analysis of important fund management issues should improve the Board's ability to proactively manage liabilities.

Recommendation #2

We recommend the Board seek legislation to increase membership by including a representative with environmental regulatory experience.

Implementation Status – Implemented

This recommendation was also implemented through passage of Senate Bill 145. Statute was amended to change the membership of the Board. Statutory revisions removed the membership position filled by an attorney with experience in environmental law. A new membership position was created for an individual with a background in environmental regulation. The total Board membership remains at seven. The new membership position should allow the Board to benefit from the skills and experience of an individual with technical and/or scientific expertise. This type of background and knowledge should become increasingly important as the Board addresses the complex technical issues associated with the management of long-term environmental remediation projects.

Recommendation #3

We recommend the Board direct staff to conduct analyses and make recommendations on fund management issues including, but not limited to, the following:

A. Future fund liability projections and methodology.

Implementation Status – Being Implemented

The Board has directed its staff to conduct ongoing analysis of future fund liabilities. Part of this effort involves site prioritization and closure procedures, and assessing liabilities associated with aboveground storage tanks (see below.) In addition, the Board's staff have indicated there is a renewed emphasis being placed on monitoring and reporting on the financial status of the fund and its exposure to liability.

B. Site prioritization and closure.

Implementation Status – Implemented

The department, rather than the Board, has implemented this part of the recommendation. The department has made several changes in procedures for prioritizing work on petroleum release sites and closing sites where no further actions are required. These changes included updates to the department's site prioritization ranking procedures, adoption of administrative rules addressing site closure and management of long-term releases, directing additional staff resources

to expediting closure of low-risk sites, and developing guidance on long-term monitoring of sites where active cleanup work is finished.

C. Regulation and financial assurance for aboveground storage tanks.

Implementation Status – Being Implemented

The Board recently formed a working group to address liabilities associated with aboveground storage tanks. The working group was formed to make recommendations regarding the future regulatory approach to aboveground tanks and the likely impact release remediation for these installations may have on the fund. The Board is developing a voluntary registration program for aboveground tanks as a first step in identifying the number and condition of these facilities. Further analysis of information for aboveground tank facilities should allow the Board to begin to assess potential liabilities. The registration program should also allow the Board to begin to establish eligibility criteria for providing financial assurance for aboveground tanks through Petrofund.

Recommendation #4

We recommend the Board document the evidence considered and reasons for decisions relating to fund eligibility appeals.

Implementation Status – Implemented

Board staff provided examples of meeting background materials provided to members prior to fund eligibility appeals discussions. Review of these documents showed Board members are now provided with specific instruction regarding the decision-making process for eligibility appeals. Instructions specifically reference the need for Board members to provide a statement of rationale for the record in cases where staff recommendations are rejected. We also reviewed Board meeting minutes for calendar year 2005 to determine if documentation standards had improved. This review showed improvements have been made in the Board's documentation of eligibility appeals decisions. In instances where the Board rejected staff eligibility recommendations, the minutes included clear statements of rationale provided by members to justify decisions.

Recommendation #5

We recommend the Board designate fund eligibility review and notification to Board staff.

Implementation Status - Implemented

The Board has designated all aspects of fund eligibility review and notification to its staff. Department personnel are no longer involved in the process of determining the eligibility status of releases. As a result of changes in the eligibility review process, Board staff have reported substantial improvements in eligibility review and approval timeliness.

Recommendation #6

We recommend the department designate the following responsibilities:

- A. Cleanup review, approval and monitoring to a single department entity.**
- B. Compensation processing to the department's office of Financial Services.**
- C. UST permitting and compliance responsibilities to the department's Permitting and Compliance Division.**

Implementation Status – Implemented

The department has made various organizational and other management changes to implement this recommendation. The Petroleum Release Section of the Hazardous Waste Site Cleanup Bureau has been designated as the sole entity responsible for cleanup review, approval and monitoring. In addition, underground storage tank compliance functions have been transferred to the department's Permitting and Compliance Division. As a result of these changes, the department eliminated the Technical Services Bureau as an organizational unit within the Remediation Division and transferred its functions to the Board or other department divisions.

Recommendation #7

We recommend the department strengthen compliance procedures by:

- A. Seeking legislation revising section 75-11-203(6), MCA, to clarify the department's authority to exclude low-risk activities from UST permitting.**

Implementation Status – Implemented

Following an examination of existing statutory authority, the department determined this part of the recommendation could be implemented without revising the law. Rather than deregulating all low-risk activities, the department has implemented changes through administrative rule to define a two-track permitting process. Low-risk underground storage tank repair and maintenance tasks are now defined as minor installations and are subject to less stringent compliance review standards. This has allowed the department's compliance program to reduce average review timeframes for minor installations and tank closures from 30 to 20 days.

- B. Targeting the use of environmental assessment questionnaires during UST permitting.**

Implementation Status – Implemented

The department has developed a screening process to ensure applicants only complete a full environmental assessment questionnaire where this is necessary.

- C. Assuring department oversight of operating permit inspectors occurs at least once during a three-year operating permit inspection cycle.**

Implementation Status – Implemented

The department has made changes in its oversight procedures to ensure all licensed tank operating permit inspectors are subject to review annually. The department has reported positive results from these changes.

- D. Compiling fire safety compliance information as part of the three-year inspection cycle to reduce eligibility processing time frames.**

Implementation Status – Being Implemented

Board staff and the department have experienced some problems in developing procedures for compiling fire safety compliance information as part of regular storage tank inspections. Board staff have indicated that this recommendation is still being considered as part of long-range strategic planning efforts. As a short-term solution, the Board staff has developed a modified

reporting procedure to allow fire safety compliance information to be obtained from the State Fire Marshall. This modified reporting procedure has been in place since October 2004 and has resulted in a 20 percent reduction in eligibility processing timeframes.

Recommendation #8

We recommend the department strengthen corrective action procedures by:

- A. Defining corrective action tasks.**
- B. Standardizing plan formats.**
- C. Determining when a corrective action plan is warranted.**
- D. Establishing formal corrective action plan amendment procedures.**

Implementation Status – Implemented

Department and board staff have worked together to develop standards and documentation relating to corrective action procedures. Private remediation consultants have also been involved in the development of improved corrective action procedures. Release cleanup work plans are now based on standardized definitions for corrective action tasks adopted by the department and the Board. The department has also standardized work plan and reporting formats used during cleanup work, and developed abbreviated work plan procedures for situations where the scope of cleanup work does not require review and approval of a comprehensive corrective action plan. The department has also developed and introduced new corrective action plan amendment procedures and has indicated these changes are working well.

Recommendation #9

We recommend the Board, in conjunction with DEQ:

- A. Develop reasonable cost ceilings for defined corrective action tasks.**
- B. Establish a timetable for implementation.**

Implementation Status – Being Implemented

Following the implementation of changes in corrective action task procedures, the Board and the department began to develop reasonable cost ceiling procedures. Reasonable cost ceilings are a cost control mechanism used during the reimbursement of claims for costs incurred by tank owner/operators during release cleanup work. The Board recently began using cost ceilings for specific corrective action tasks. The Board plans to expand use of reasonable cost ceilings to other corrective actions tasks as more historical cost claims data becomes available. Board staff have reported some initial cost savings resulting from the implementation of the cost ceilings approach and expects to realize further savings as more corrective actions tasks are subject to improved cost controls.

Recommendation #10

We recommend the legislature outline steps to transition Petrofund coverage to private insurers by:

- A. Requiring all owner/operators installing new tank systems to purchase private insurance or provide proof of financial assurance other than Petrofund.**
- B. Phasing-in private insurance coverage or alternative financial assurance for owner/operators of tanks meeting all the 1998 upgrade requirements.**

- C. Phasing-in private insurance coverage or alternative financial assurance for owner/operators of all remaining underground and aboveground petroleum storage tanks and terminating Petrofund.**
- D. If necessary, developing interim transition incentives for owner/operators, including a reinsurance/excess coverage program to mitigate the initial effects of insurance premiums.**

Implementation Status – Partially Implemented

This recommendation was addressed to the legislature and was partially implemented through passage of Senate Bill 145 during the 2005 session. The bill amended statute to include provisions requiring the Board to compile and report information on the availability of petroleum storage tank liability insurance in the private sector. The Board is also now required to report on the continuing need for collection of all or part of the petroleum tank release cleanup fee. The market for private release liability insurance continues to be subject to volatility due to uncertainty created by federal court decisions. However, Board staff have reported that the potential for transitioning liabilities for new releases to alternative coverage remains under active consideration and they will continue to analyze options for addressing the future of the fund. Board staff are also placing more emphasis on identifying existing liability coverage for petroleum tank installations. By encouraging owner/operators to apply for coverage of releases under general business or other liability insurance policies, Petrofund can function as the insurer of last resort, rather than the default coverage option. By ensuring release liability is covered in the first instance by existing private liability insurance, the Board can reduce demands on the fund and better safeguard its long-term viability.